

# Finland broadens scope of the Finnish transfer pricing adjustment provision

February 21, 2022

## In brief

Finland has introduced a new amendment to the Tax Assessment Procedure Act which entered into force on January 1, 2022. The new amendment widens the scope of the Finnish transfer pricing adjustment provision by enabling the Finnish tax authorities to:

- Disregard or recharacterize intra-group transactions agreed by the parties under certain circumstances, and
- Apply the OECD Transfer Pricing Guidelines in full in proportion to transfer pricing adjustments in Finland.

**Action item:** Taxpayers should take steps to prepare high-quality transfer pricing documentation, detailed functional analysis, and focus on in-depth comparability analysis so that adequate proof of the transfer pricing method and pricing chosen exists to lessen the likelihood of transfer pricing adjustments initiated by the Finnish Tax Administration.

## In detail

### Background

Finland's Ministry of Finance issued a proposal concerning the revision of the Finnish transfer pricing adjustment provision on October 21, 2021. This revision has been in process since 2014; however, the previous draft government bill was deemed problematic and never took effect.

Tax treatment in Finland has traditionally followed the legal form. Prior to the amendment it was not possible to disregard or recharacterize transactions that have been implemented by common consent of the parties. Finland's Supreme Administrative Court has stated in several rulings that the previous transfer pricing adjustment provision did not allow the Finnish tax authorities to disregard or recharacterize transactions agreed to by the parties. Evaluating whether a certain business transaction followed the arm's-length principle, the assessment had to be based on the actual transaction agreed on and implemented in the manner structured by the associated enterprises in the transaction. The Supreme Administrative Court also stated that an explicit legislative authorization — previously not included in the Finnish transfer pricing adjustment provision — would be required to make such transfer pricing adjustment.

In Finland, the OECD Transfer Pricing Guidelines have an interpretative effect, but due to national legislation it has not been possible to refer to those guidelines for recharacterization and disregarding of transactions. Since the

previous transfer pricing adjustment provision only allowed for the tax authorities to make changes in pricing and did not allow the alteration of the transaction itself, the transaction could not be disregarded or recharacterized.

Prior to the amendment, the application of the general tax avoidance provision (Section 28 of the Tax Assessment Procedure Act) was required to disregard a transaction or to replace it with another transaction, making the previous scope of the national transfer pricing adjustment provision more limited than what would be permitted under the OECD Transfer Pricing Guidelines.

## Legislative amendment

Under the current transfer pricing adjustment provision allows the Finnish Tax Administration to make transfer pricing adjustments to the full extent allowed by the OECD Transfer Pricing Guidelines. In accordance with the OECD's approach, intra-group transactions are classified based on their economic substance; in exceptional circumstances, the tax authorities may disregard intra-group transactions or recharacterize them by their economic substance. The amendment applies to tax years beginning on or after January 1, 2022.

An accurately delineated transaction may be disregarded and replaced with another transaction only under exceptional circumstances. Specifically, the tax authorities can only disregard an economically irrational transaction if they are unable to determine the arm's-length transfer price. In the prior government proposal, the threshold for disregarding an intra-group transaction was purportedly high. Nevertheless, a transaction can still be replaced for transfer pricing purposes in a situation where the general tax avoidance provision would not apply. It is yet to be seen whether the amendment leads to a rise in tax audits.

An accurate evaluation of the factual substance of an intra-group transaction is required before determining whether the transaction meets the arm's-length principle under the revised provision. An analysis of the commercial and financial relations and its economically relevant characteristics must be concluded to identify the transaction.

### Observation

Although the amendment aligns the scope of the Finnish transfer pricing adjustment provision with the OECD Transfer Pricing Guidelines, the changes mark a significant shift in the Finnish tax system when it comes to respecting the legal form of transactions agreed to by the associated enterprises. The amendment introduces the substance-over-form principle to the Finnish transfer pricing practice as the tax authorities may, in some cases, characterize transactions differently from the legal form of the transaction or what the taxpayer perceives it to be.

## The takeaway

With this amendment, the Finnish tax authorities have the ability to challenge both the transfer pricing models and the pricing itself. In the light of these changes, it is important for multinational groups with operations in Finland to keep their contract terms up to date, evaluate their current transfer pricing models, and take steps to make sure their transfer pricing models are following the arm's-length principle. Taxpayers should include the assessment of the economic substance of their intra-group transactions in their transfer pricing documentation process or whenever they assess the arm's-length nature of their intra-group transactions. If necessary, the Finnish Tax Administration still provides an opportunity to apply for the preliminary discussions.

## Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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